IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE NO. 54 OF 1998

For Approval and Signature:

HONOURABLE MR.JUSTICE R.S.GARG

HONOURABLE MR.JUSTICE D.H.WAGHELA

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the Civil Judge?

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V.G. GANATRA, DEVELOPMENT OFFICER - Applicant(s)
Versus
COMMISSIONER OF INCOME TAX - Opponent(s)

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Appearance :
SHRI S.N. DIVETIA for Applicant(s).
SHRI MANISH R BHATT for Opponent(s).

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CORAM : HONOURABLE MR.JUSTICE R.S.GARG
and
HONOURABLE MR.JUSTICE D.H.WAGHELA

Date : 01/11/2006

ORAL JUDGMENT
(Per : HONOURABLE MR.JUSTICE R.S.GARG)

In relation to I.T. Appeal Nos.2488 to 2490/Ahd/1992 pertaining to Assessment Years 1985-86, 1986-87 and 1988-89, the Income Tax Appellate Tribunal,

Rajkot Bench, Rajkot, at the instance of the Assessee, has made this Reference under Section 256(1) of the Income Tax Act, 1961 (hereinafter referred to as `the Act' for short) for the opinion of this Court on the following question:

> *"Whether the Income-tax Appellate Tribunal is right in law in holding that no deduction can be allowed to the assessee in respect of earning incentive bonus as expenses for earning the same apart from standard deduction as envisaged in section 16(1) of the I.T. Act as the bonus partakes the character of salary as envisaged in section 17(1) of the I.T. Act, 1961?"*

2. The Assessee, who is a Development Officer with Life Insurance Corporation of India, earned certain incentive bonus. In the return, he claimed 100% deduction from the taxable income in relation to the incentive bonus on the ground that he had undergone certain expenses and incentive bonus is not taxable.

2.1 The Assessing Officer, after hearing the parties, observed that no deduction could be allowed in respect of earning incentive bonus apart from standard deduction, as envisaged in Section-16(1) of the Act, as the bonus partakes the character of salary as envisaged

in Section 17(1) of the Act. In the appeal at the instance of the Assessee, the learned Deputy Commissioner of Income Tax (Appeals), Jamnagar, came to the conclusion that the Assessee was entitled to deduction to the extent of 40% as expenses claimed by the Assessee.

2.2 The Revenue, being aggrieved by the said order passed by the CIT (Appeals), preferred the above referred appeals. The Tribunal had passed a short order observing that the order of the Assessing Officer should be confirmed and that of the CIT (Appeals) should be reversed. In the name of findings, the Tribunal recorded that it agreed with the Assessing Officer that no deduction could be allowed in respect of earning incentive bonus apart from standard deduction as envisaged in Section-16(1) of the Act.

2.3 The Assessee, being aggrieved by the said order, filed an application for Reference, on which this Reference has been made on the above referred question.

3. The parties before us submit that an identical question has been considered by this Court in the matter of ***Commissioner of Income-Tax vs. Kiranbhai H. Shelat & Anr.*** [***235 ITR 635***] and this Reference can be disposed of in terms of the answer/decision rendered in the said matter.

4. In the matter of ***Commissioner of Income-Tax vs. Kiranbhai H. Shelat*** (*supra*), the Court has, in effect, observed that:

> *"The Life Insurance Corporation of India is a statutory body. It grants incentive bonus to its Development Officers. The incentive bonus has two components. It is to be paid only when extra business is procured for the Life Insurance Corporation. The Life Insurance Corporation admitted in its letter to the Central Board of Direct Taxes that the incentive bonus is granted to the employee with a view to meet the expenses that might have to be incurred by him as Development Officer for the discharge of his duty. Therefore, when the expenses are actually incurred by the Development Officer, from that component which may fall under section 2(24) and be treated as income, in cases where such income does not fall in the exemption category under section 10(14), it is the profit element alone which remains with the assessee that can be treated as salary, being profit in addition to salary or wages. The Life Insurance Corporation had proposed to certify 30 per cent of the incentive bonus earned as necessary expenses that would have to be incurred. Therefore, in all cases governed by section 10(14) as it stood prior to April 1, 1989, when the requirement of Government notification (later changed to `as may be prescribed') was superimposed, all the expenses designated for*

the purpose and actually incurred stood exempted and could not be included in the total income of such assessee. Since only 30 per cent of the incentive bonus earned was intended to meet such expenses, no higher amount could be claimed by such assesses as expenditure incurred out of the special allowance given for that purpose. That exemption applied only to the extent the expenses were actually incurred for the purpose for which they were granted. If any amount was not so expended out of the amount up to 30 per cent incentive bonus earned, and as a result, it ended as profit to the assessee-Development Officer, that would be `profits in addition to his salary' under section 17(1)(iv) and, therefore, will fall in the head of income under the head `Salaries'. Even in cases falling after April 1, 1989, when section 10(14) came to be amended and the exemption was confined only to notified allowances (later amended with effect from April 1, 1989, as prescribed allowances), wherein the income covered by section 2(24) in the nature of 30 per cent of the incentive bonus earned is not exempted by the provisions of section 10(14), such allowances as are income within the meaning of section 2(24), cannot be straightaway treated as a salary. It will have to be ascertained whether the expenditure intended to be met was actually incurred and if so incurred whether any part of such special allowance still remained with the employee so as to be described as profit in addition to his normal salary and wages. This

exercise will have to be confined only to 30 per cent of the incentive bonus earned which alone was intended by the Life Insurance Corporation as a special allowance granted to the Development Officers to meet the expenses for the discharge of their duties of office and would, therefore, be a special allowance specifically granted to meet the expenses for the discharge of duty. If out of such 30 per cent of the incentive bonus earned, any amount is not actually expended for the purpose intended, then there would be no question of reimbursing any sum which is not reimbursable and that part will be profit and gain to the assessee and will be treated as salary under section 17(1)(iv) of the Act. Even if the expenses component of the incentive bonus is not to be treated as a special allowance specifically granted to the assessee within the meaning of section 2(24), the receipt of the entire incentive bonus will have to be examined as something given in addition to the salary or wages of the Development Officer, especially when it is specifically kept out of the `annual remuneration' of Development Officers as defined in the Rules regulating the terms and conditions of their service. Even in such a case, it will have to fall in one of the categories named in section 17(1) for being put under the head income from `salaries'. There again the closest it goes is to section 17(1)(iv) as `profits in lieu of salary or in addition to salary'. Therefore, the assesses' profit in that case also will have to be worked

out which cannot be done unless the expenditure which is necessary and was properly incurred for the purpose of earning the income, is deducted therefrom. This deduction cannot be denied to the assessee employee on the ground that the statutory deductions are already provided in section 16."

5. After hearing the parties and on going through the judgement in the matter of ***Commissioner of Income-Tax vs. Kiranbhai H. Shelat*** (*supra*), we are of the opinion that the question can be answered in the following terms:

The Appellate Tribunal was not justified in restoring the order of the Assessing Officer, nor even the CIT (Appeals) was justified in allowing 40% of the deduction because the Assessing Officer would be justified in allowing incentive bonus as deduction only to the extent of reimbursement of expenses actually incurred upto the maximum limit of 30% of the incentive bonus earned by the Assessee. The Reference is, accordingly, answered. It stands disposed of. No costs.

[***R.S.Garg, J.***]

[***D. H. Waghela, J.***]

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